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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936

No. 330

THE UNITED STATES, *Petitioner*

v.

AUTOMATIC WASHER COMPANY, *Respondent*

ANSWER IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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Respondent, by counsel, respectfully prays that the petition for a writ of certiorari be denied for the reasons hereinafter set forth.

The basis for the petition is the allegation that the decision of the Court of Claims conflicts with the decision of the Circuit Court of Appeals for the Second Circuit in *Founders General* v. *Hoey* (not yet reported) which, in turn, is in conflict with the decision of the Seventh Circuit in *A. B. Leach & Co.* v. *United States* (not yet reported), in which the Government has petitioned for certiorari (No. 331, Present Term).

It is true that the decisions of the Second and Seventh Circuits are in sharp conflict. The case at bar, however, turns upon an entirely different question from the one

involved in the *Founders General* and the *Leach* cases and, regardless of the principle to be ultimately established in those cases, the decision of the Court of Claims would have to be affirmed.

In order that this Court may have concisely before it the clear distinction between the question involved in the case at bar and the one involved in the *Founders General* and *Leach* cases, a brief discussion follows.

REASONS FOR DENYING THE WRIT.

The tax in each of the three cases above mentioned was collected under the alleged authority of Schedule A (3) of Title VIII of the Revenue Act of 1926 which, among a variety of other bases, imposed a documentary or stamp tax of 2c per share on the

> "transfer of legal title * * * to rights to receive such shares."

In both the *Founders General* and *Leach* cases, the taxpayers had subscribed for shares of stock in certain corporations and, as such subscribers, had acquired "legal title" to the "rights to receive" the shares thus subscribed for. In each of those cases, the taxpayer instructed the respective corporations to issue the shares in the name of a third person who had no beneficial interest in the shares but who was, in each instance, merely a temporary nominee. The question in those two cases was, as the Government correctly states, whether the issuance of stock to the bare nominee of a person who had the *legal right to receive the shares himself,* constituted a taxable "transfer of legal title" to the "right to receive" such shares under the statute quoted above. The Second Circuit held that it did; the Seventh Circuit that it did not.

In the case at bar, the stockholders of the Automatic Washer Company (who are the alleged transferors) *never had any legal or other right or title to the "right to re-*

ceive'' the shares of stock which they are alleged to have transferred to their attorney-in-fact. *Hence, they did not transfer and could not have transferred ''legal title'' to the alleged ''right to receive'' the stock.* It is therefore immaterial, in the case at bar, whether the transfer to a nominee of ''rights to receive'' stock is taxable or not; for in this case *no legal right or title ever vested in the stockholders.* A brief restatement of the facts will amply disclose this situation.

On June 22, 1928, one Nelson, a stockholder and officer of the old company, entered into an agreement with the ''Bankers'', the substance of which was that the old company would be reorganized and the Bankers given an option to purchase 40,000 shares of new common and 34,538 shares of new preferred stock out of a proposed recapitalization of 180,000 shares of common and 40,000. shares of preferred stock of the new or reorganized company.

On September 17, 1928, Nelson secured from all the stockholders of the old company irrevocable (to November 15, 1928) powers of attorney, the material and identical provisions of each authorizing him, in connection with the reorganization, to

> ''receipt for and receive* * * and to sell, exchange or dispose of, for me in my behalf any and/or all property or assets so received, including all or any portion of the shares of stock or other securities of the New Company accruing to me, or to which I am or may become entitled by reason of the consummation of any plan of reorganization of the affairs of the Old Company and particularly * * * to sell and dispose of any and/or all such shares of stock and/or securities in consummating the agreement or agreements now existing between the said H. E. Nelson and Folds, Buck & Company'' (Tr. p. 8).

On September 27, 1928, the New Company (this respondent) having meanwhile been created, entered into an agreement with the Old Company whereby the Old Com-

pany agreed to sell to the New Company all of its assets in consideration of the New Company's issuing to the stockholders of the Old Company all of its common and preferred stock *with the following important qualification:*

> "In order to carry out this plan * * * each of the stockholders of the Old Company has irrevocably constituted and appointed H. E. Nelson and W. N. Gallagher his attorneys in fact to receive the respective securities of the New Company to which such stockholder may be entitled and to make sale of that portion thereof to be contributed by such stockholder for the purpose of carrying out said agreement of sale with the Bankers * * *.
>
> "Accordingly, the New Company, * * * shall issue such certificates in such names and for such amounts as shall be specified in the joint order of the said H. E. Nelson and W. N. Gallagher, the attorneys in fact * * * and deliver the same to said attorneys in fact, * * *" (Tr. p. 7).

In substance, the New Company acquired all of the Old Company's assets upon its agreement (forthwith executed) to issue 100,000 shares of its new common to the old stockholders and 40,000 shares of new common and 34,538 shares of new preferred to Nelson for ultimate sale to the bankers.

In Raybestos-Manhattan Company v. *United States*, 296 U. S. 60, this Court held that where one corporation sells its assets to another corporation in return for the purchasing corporation's stock, the "right to receive" such stock *belongs to the selling corporation* which has "the power to command the disposition of the shares" and where such selling corporation stipulates that the stock is to be issued directly to third persons, it has nonetheless transferred its primary "right to receive" such stock and has thus incurred a tax liability. Respondent recognized this principle and agreed to the tax on the transfer by the Old Company of its "right to receive" *all* of the new stock of which 100,000 common shares were issued to the old

stockholders and the balance to Nelson. The Government, however, contends that the old stockholders had the "right to receive" *all* of the new stock and that they, in turn, transferred to Nelson their "right to receive" the Bankers' stock, thus incurring an additional tax.

The complete answer to this contention is that, under the rule of *Raybestos-Manhattan,* the stockholders acquired no "right to receive" any stock *except under the agreement of September 27, 1928 between the Old and New Companies.* On September 17, 1928, however, all the stockholders had irrevocably relinquished every claim or right to receive the Bankers' stock and the agreement of September 27th expressly recognized, *as one of the essential conditions of the reorganization,* that the old stockholders had irrevocably waived any claim to receive the Bankers' stock, as such.

Hence, the powers of attorney of September 17th, (which are claimed to be the instruments effecting the transfer of the stockholders' "rights to receive" the Bankers' stock) were at most *mere waivers of any claims that the stockholders might later acquire to receive the Bankers' stock.* They certainly did not effect any "transfer of legal title" to "rights to receive", for no such rights existed on September 17, 1928. The Court of Claims very properly, therefore, said that the Government's argument, reiterated in this Court,

> "overlooks the decision of the Supreme Court in the case of Raybestos-Manhattan Co. v. United States, 296 U. S. 60. *The right to receive the stock of the new company was under the foregoing decision vested in the old company* * * *." (Italics ours)

Respondent's position finds added and directly pointed authority in the decision of the Ninth Circuit in *McLaughlin, Collector* v. *Coos Bay Lumber Company,* 80 Fed (2d) 763. In that case the bondholders of an insolvent corporation transferred title to certain bonds to a bondholders'

protective committee which later succeeded in effecting a reorganization under which the corporation issued to the bondholders' committee shares of new stock in the reorganized corporation in exchange for the old bonds. The Government claimed that these new shares were the property of the old bondholders and that the old bondholders had transferred to the protective committee their rights to receive the new shares, thus subjecting the transaction to a tax under Schedule A(3).

In denying the Government's contention and in holding that no tax was incurred, the Circuit Court of Appeals said:

> "In the instant case, we think the controlling factor is the determination of the *time when the right to receive the stock came into existence.* When the bondholders deposited their bonds, they conveyed to the members of the committee the legal title; * * *. When the plan was approved by appellee, a right to receive stock was vested in the owners of the title to the bonds who would be and were the members of the committee. *And since the right to receive the stock was not vested in the bondholders, they could not transfer such right.*" (Italics ours)

In the case at bar, the old stockholders never became entitled to receive any new shares until after the agreement of September 27th. *Raybestos-Manhattan* v. *United States, supra.* Prior to that time they had all irrevocably agreed that Nelson should receive and sell the Bankers' shares. On September 27th, therefore, the stockholders *had no right or title to the Bankers' shares which was capable of transfer.* In other words, they had already relinquished *"the power to command the disposition of the shares"* which this Court has said in the *Raybestos-Manhattan* case is the criterion of the "right to receive".

It is, therefore, submitted that the question presented in this case is entirely distinct from the one inhering in the *Founders General* and *Leach* cases. In the latter cases,

the question is whether the transfer to a nominee of an *undisputed* right to receive stock is taxable. In the case at bar, the question is whether any "right to receive" *ever existed at all.* This latter question has already been answered by this Court in *Raybestos-Manhattan* v. *United States, supra.*

ERRORS IN THE GOVERNMENT'S PETITION FOR CERTIORARI.

The foregoing position furnished the basis for the taxpayer's argument in the court below. The general question of liability in a so-called "nominee" transaction was there, as here, asserted to be immaterial. While the opinion of the Court of Claims is not as clear upon this point as might be desired, nevertheless, when the foregoing is considered, it seems fairly apparent from the language of the opinion below that the Court agreed with the taxpayer's contention as to the precise question involved. The Government's petition loses sight of this fact in asserting that the question in this case and the *Founders General* and *Leach* cases is the same.

A more obvious error (inadvertent, of course) is found in the Government's "Specification of Errors". Specification 4 on page 7 of its petition recites that the Court of Claims erred "in failing to enter judgment for the United States and *dismissing the petition*".

Of the 34,538 shares of preferred and 40,000 shares of common stock issued to Nelson for sale to the Bankers, 6,104 shares of preferred and 7,069 shares of common stock represented Nelson's individual *pro rata* contribution, as a stockholder of the old company, to the total shares sold to the Bankers. The Commissioner of Internal Revenue held that Nelson had transferred *to himself* his right to receive these 13,173 shares and the tax on these shares is a part of the tax sued for and recovered in the Court of Claims.

Upon the argument of the case below, the Government conceded that no liability was incurred as to these 13,173 shares and confessed judgment as to that portion of the tax. This fact the Court of Claims expressly noted in its opinion. The petition for certiorari, however, overlooks this situation and asserts that the Court of Claims erred in not "dismissing the petition."

CONCLUSION.

Upon the foregoing, it is respectfully submitted that

1. The question in this case is entirely distinct from the one involved in the *Founders General* and *Leach* cases and

2. The precise question has already been definitely settled by this Court in *Raybestos-Manhattan* v. *United States, supra.*

WHEREFORE, it is prayed that the petition for a writ of certiorari be denied.

Respectfully submitted,

JESSE L. MILLER,
Attorney for Respondent.